Economic integration describes a process whereby countries coordinate and link their economic policies. As the degree of economic integration increases, the trade barriers between countries decrease and their fiscal and monetary policies are more closely harmonized.

A bilateral trade agreement is an agreement relating to trade between two countries. The aim is usually to reduce or remove tariffs and/or quotas that have been placed on items traded between the two countries.

A multilateral trade agreement is an agreement relating to trade between multiple countries. It also usually aims to reduce or remove tariffs and/or quotas that have been placed on traded items, but the agreement in this case applies to all of the multiple countries involved.

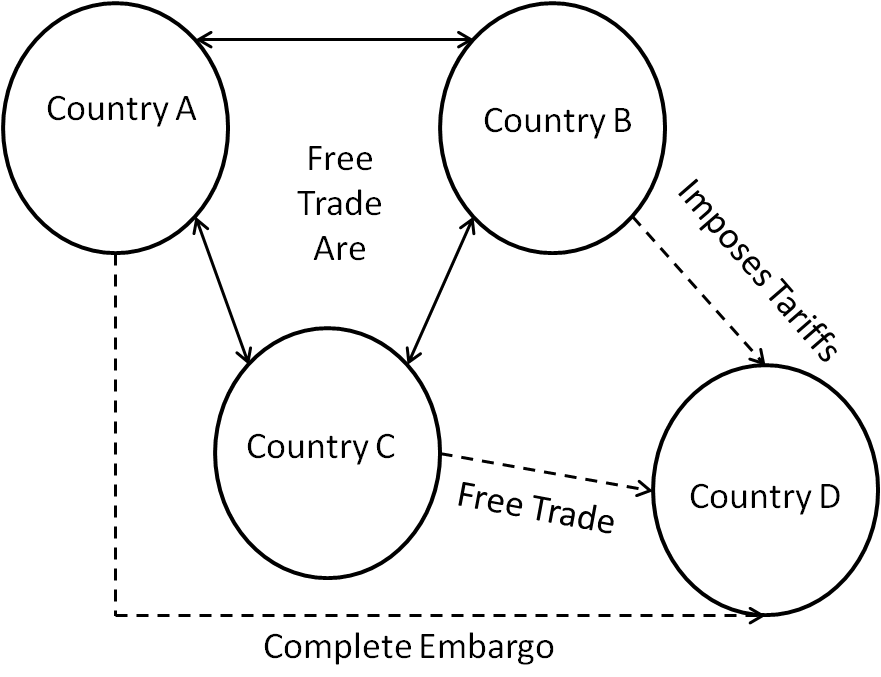
**Trading Blocs**   
A trading bloc is defined as a group of countries that join together in some form of agreement in order to increase trade between themselves and/or to gain economic benefits from cooperation on some level. This coming together is economic integration. The Hungarian economist Bela Balassa identified six stages of economic integration:

1. *Preferential trading areas:* A preferential trading area (PTA) is a trading bloc that gives preferential access to certain products from certain countries. This is usually carried out by reducing, but not eliminating, tariffs.

An example of a PTA is the one between the EU and the African, Caribbean, and Pacific Group of States (ACP). This is an agreement between the EU and 78 countries in the ACP. Many of the countries were former colonies of EU members. It enables the EU to guarantee regular supplies of raw materials and the ACP countries to gain tariff preferences and access to special funds that are used to try to achieve price stability in agricultural and mining markets.

Since 2008 the arrangement has been a “reciprocal trade agreement”. This means that the EU provides duty-free access to its markets for exports from the ACP countries and also receives duty-free access for its own exports to the ACP

However, it is agreed that not all of the ACP countries have to open up to EU exports. The least-developed countries in the ACP group may opt for other arrangements.



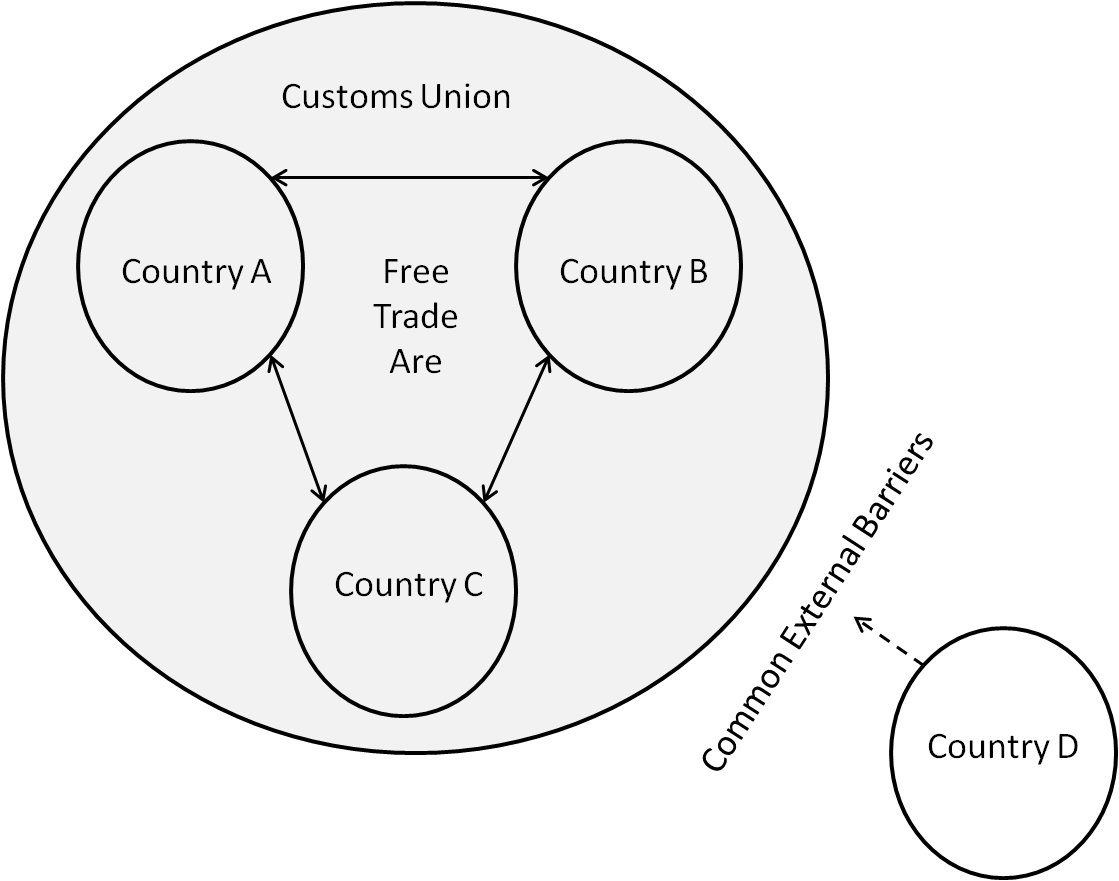
1. *Free trade areas:* A free trade area is an agreement made between countries, where the countries agree to trade freely among themselves, but are able to trade with countries outside of the free trade area in whatever way they wish.

In this hypothetical case, countries A, B, and C have signed a free trade agreement and are now trading freely among themselves. However, under the agreement, each country may trade with any other country in any way it sees fit. Thus country A has political grievances with country D and so has placed a complete embargo on foreign trade. Country B protects its economy from country D by placing tariffs on a number of its imports. Country C has good relationships with country D and trades freely with it.

An example of a free trade area is the North American Free Trade Area (NAFTA), which comprises the USA, Canada, and Mexico. NAFTA was established in January 1994 and, following a final tariff reduction between Canada and Mexico in January 2003, virtually all trade in the NAFTA region is tariff-free. Over 75% of Canadian total exports now go to the USA, and Mexico’s share of the US import market has grown from approximately *7%* in preNAFTA times to approximately 12% today.

Other examples of free trade agreements are the European Free Trade Association (Iceland, Norway, Switzerland, and Liechtenstein), and the South Asia Free Trade Agreement (India, Pakistan, Nepal, Sri Lanka, Bangladesh, Bhutan, and the Maldives).

1. *Customs unions:* A customs union is an agreement made between countries, where the countries agree to trade freely among themselves, and they also agree to adopt common external barriers against any country attempting to import into the customs union.

Countries A, B, and C have joined in a customs union and are trading freely with each other. If country D wishes to export goods to the customs union, the goods will be treated in the same way, no matter which country the goods enter. If the customs union has agreed to place tariffs on the products of country D, then those   
tariffs will be imposed, no matter what the point of entry to the customs union.

All common markets and economic and monetary unions are also customs unions, thus the EU has a customs union. Other examples would be the Switzerland—Liechtenstein customs union; the East African Community, which is a customs union comprising Kenya, Uganda, and Tanzania; and Mercosur, which is a customs union between Brazil, Argentina, Uruguay, Paraguay, and Venezuela.

1. *Common markets:* A common market is a customs union with common policies on product regulation, and free movement of goods, services, capital, and labor. The best-known example of a common market is the EU. The CARICOM Single Market and Economy (CSME) is another example, which is expected to be fully implemented with harmonization of economic policy and, possibly, a single currency. The current members are Barbados, Belize, Guyana, Jamaica, Suriname, Trinidad and Tobago, Antigua and Barbuda, Dominica, Grenada, St Kitts and Nevis, St Lucia, and St Vincent and the Grenadines. Montserrat is also expected to join.

End of Reading #1

1. *Economic and monetary union:* An economic and monetary union is a common market with a common currency and a common central bank. The best example of an economic and monetary union is the euro zone, which includes the member countries of the EU that have adopted the euro as their currency and have the European Central Bank (ECB) as their central bank. In 2010, the members consisted of Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain.

There are a number of advantages of a monetary union for the   
member countries.

* Exchange rate fluctuations that used to exist between countries will disappear with a common currency and this should eliminate exchange rate uncertainty between the countries involved, which should increase cross-border investment and trade.
* A currency which has the enhanced credibility of being used in a large currency zone should be more stable against speculation than the individual currencies were.
* Business confidence in the member countries tends to improve as there is less of a perceived risk involved in trading among the countries. This in turn should lead to both internal growth and trade growth.
* Transaction costs are eliminated within the monetary union. When countries have different currencies there is a charge when currencies are exchanged, but this will not happen with the existence of a single currency.
* A common currency makes price differences more obvious between countries and should, over time, lead to prices equalizing across borders.

There are also a number of disadvantages of a monetary union for   
the member countries.

* When countries enter a monetary union, interest rates are decided by the central bank. This means that individual countries are no longer free to set their own interest rates and so the tool of monetary policy (see Chapter 14) is no longer an option to influence the inflation rate, the unemployment rate, and the rate of economic growth. This is especially damaging if one country in the union is experiencing an economic situation that is not being experienced by the others. For example, if one country was experiencing high inflation due to strong consumer demand, which other countries were not, it might want to increase interest rates to reduce the demand. However, this would not happen and other measures would have to be found.
* While a common central bank is seen as a prerequisite of monetary union, many argue that without fiscal integration, in the form of a common treasury, harmonized tax rates, and a common budget, a monetary union will be weak and vulnerable, since some countries will be more fiscally irresponsible than others and this may threaten the stability of the union. Individual countries are not able to alter their own exchange rates in order to affect the international competitiveness of their exports or the costs of their imports.
* The initial costs of converting the individual currencies into one currency are very large. The costs include such things as taking the old currencies off the market, printing and distributing the new currency, converting databases and software, rewriting all price lists and invoice systems, re pricing all goods and services in the economy, and recalibrating all machinery that takes coins and notes, such as parking meters and vending machines.

It is almost impossible to weigh up the advantages and disadvantages of membership of a monetary union. The situation will be very different in different cases. Perhaps it is best to try to determine when membership would be most beneficial and when it would make the least difference.

In a situation where there were large fluctuations between the exchange rates of the countries involved, where the union is going to create a single currency with a significant proportion of the world’s foreign currency market and where business confidence will be strongly boosted between member countries, then it is likely that membership of a common currency will be beneficial to the individual countries.

If countries are in a situation where fluctuations in exchange rates are minimal, where the common currency would not be significant on the world market, so would still be susceptible to speculation, and where business confidence is already high, then the advantages of joining a single currency would be few and the disadvantages may well be greater.

1. *Complete economic integration:* This would be the final stage of economic integration, at which point the individual countries involved would have no control of economic policy, full monetary union, and complete harmonization of fiscal policy. This is what the Euro zone is moving towards.

**An Evaluation of Trading Blocs**The extent of the advantages and disadvantages of trading blocs clearly depends on the degree of integration. In purely economic terms, the benefits of being a member of a trading bloc are similar to those of free trade. These include a greater size of market with the potential for larger export markets, increased competition leading to greater efficiency, more choice, and lower prices for consumers. The consequences may not be even, as some domestic producers are likely to gain from the larger market while others may find themselves unable to compete.

There may be a further stimulus for investment due to the larger market size, and foreign investment might be attracted from outside the bloc as a way of getting a foot in the door of the larger market.

There is also an argument that, along with the economic gains, a trading bloc will foster greater political stability and cooperation. It is also possible that trade negotiations may be easier in a world made up of a number of large trading blocs, rather than among 149 sovereign states.

However, by their very nature, trading blocs favor increased trade among members, but enact discriminatory policies against non-members, and this can be damaging to the achievements of the multilateral trading negotiations of the WTO. There is concern that the breakdown in WTO talks in Geneva in July 2006 will lead to an increase in the number of individual trade negotiations. These may undermine the international trade rules and limit the potential gains to trade achievable with more liberalized world trade. This may not be as much of a problem for large economies as it might be for small or poor economies that have little bargaining power.

End of Reading #2